The Pakistan Credit Rating Agency Limited

Rating Report

Sapphire Dairies (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
07-Aug-2024	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The assigned ratings for Sapphire Dairies (Pvt.) Limited ("the Company" or "SDPL") reflect the prominent profile of its sponsoring group, the Sapphire Group, a renowned textile conglomerate in Pakistan. The group has appreciable business diversity in multiple industry segments including; Power, Cement, Real Estate and Dairy. Sapphire Dairies is a strategic venture of the group, driven by the vision that corporate farms can enhance dairy economics and hygiene standards for the people of Pakistan and its investors. SDPL engages in the rearing and farming of dairy animals and has transformed into a fully vertically integrated dairy unit. The company operates a state-of-the-art corporate dairy farm, equipped with a fully automated milk collection mechanism and real-time production status updates. The processing and packaging facility of processed Milk, Dairy and Fruit beverages meets the high-end international quality standards. The board of SDPL is more of an advisory nature accompanied by professional management. In terms of revenue contribution, SDPL's primary product is raw milk, followed by other dairy and fruit beverages, as well as related products. During 9MFY24, the Company reported a topline of PKR 3,197.79mln (9MFY23: PKR 2,430.76mln, FY23: PKR 3,400.93mln), mainly attributed to the inflationary impact on milk pricing. The generation of non-core income from revaluation gain on the dairy livestock has supplemented the profitability matrix of the Company as it operates in a fundamentally low-margin-based industry. The company devised a business strategy to channel its revenue streams into the export segment, and SDPL recently exported a batch of fruit beverages. Contemporary genetics improvement practices in dairy breeds, as adopted by the company, has enabled it to enhance milk yield of its cattle base. The financial risk profile of the company is considered adequate, with an aptly managed working capital cycle due to the perishable nature of the product. The cashflows and coverages of the Company are considered adequate. The Company maintained a moderately leveraged capital structure with short-term borrowing to fuel working capital requirements mainly dedicated to the procurement of feed. The high sensitivity in raw milk pricing, ensuring availability of feed, prudent management of livestock and treasury operations coupled with a change in the regulatory framework are the prime challenges specific to the industry.

The ratings are dependent on sustainable growth in the profits while expanding the business volumes. The maintenance of coverages and cashflows at an optimal level plays a pivotal role in ratings. The realization of synergies after venturing into the export segment remains critical.

Disclosure

Name of Rated Entity	Sapphire Dairies (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-24),Methodology | Corporate Rating(Jul-24)
Related Research	Sector Study | Dairy(Aug-24)
Rating Analysts	Muhammad Harris Ghaffar | harris.ghaffar@pacra.com | +92-42-35869504

Profile

Legal Structure The Sapphire Dairies (Private) Limited ("the Company" or "SDPL") is a private limited company.

Background SDPL was incorporated on January 31, 2008, as part of the sponsors' strategy to expand their footprint in the dairy sector to augment business diversity, with the vision that corporate farming can enhance dairy economics and hygiene standards.

Operations The principal activity of SDPL is the operation of a dairy farm focused on the production and processing of milk and dairy products. SDPL produced ~21 million gross liters of milk in FY23. The head office and registered office are situated at 7 A-K, Main Boulevard, Gulberg, Lahore and the production farm is located on Manga Raiwind Road in District Kasur, facilitating streamlined production and distribution processes.

Ownership

Ownership Structure The company is a subsidiary of Diamond Fabrics Limited, which holds a 53.75% stake in the company. The rest of the shareholding lies with other group companies.

Stability The stability in ownership mainly vests in Sapphire Group as the sponsors have a long-term association with the Company and an appreciable presence in multiple sectors.

Business Acumen The sponsors possess extensive experience spanning multiple sectors, including textiles, power, dairy, and retail. In key executive roles, they have driven significant growth and fostered innovation within their respective industries.

Financial Strength The financial strength of the Company derive from financial muscles of the group. The Sapphire Group's appreciable presence in diversified sectors exhibit the ability to support the Company in hour of need.

Governance

Board Structure The board of SDPL is more of an advisory nature. The board comprises five members from the sponsoring group.

Members' Profile Mr. Mian Mohammad Abdullah is the Chairman and Founder of the Sapphire Group of Companies. He has been honored twice with Pakistan's top civilian award, Sitara-e-Imtiaz, for his contributions to business. All board members have had a long association with the group and bring extensive experience to their roles.

Board Effectiveness No board committees are established. Board meetings are held as needed to present financial results and discuss the company's overall performance. Minutes of these meetings are recorded and maintained.

Financial Transparency M/s ShineWing Hameed Chaudhri & Co Chartered Accountants are the external auditors of the Company and have issued an unqualified opinion on the financial reports for the year ended June 2023.

Management

Organizational Structure The Company's organizational structure includes business units and shared services. The business units includes SDL Farm and SDL Processing which cumulatively manage calf care, feeding, health, parlor, breeding, production, quality control, and warehousing. Shared services support functions such as engineering, IT, accounts, MIS, HR, administration, internal audit, tax, supply chain, and finance.

Management Team The management team of SDPL includes seasoned professionals with diverse experience. Mr. Amer Abdullah is CEO of the Company. He has spearheaded several textile expansion projects and diversified the dairy business. Mr. Arslan Ahmad, Deputy General Manager of Accounts & Finance, oversees financial operations. Mr. Faizan Elahi, the Business Unit Head since 2014, leads operational strategies and growth initiatives.

Effectiveness There are no management committees in place and the management meets informally to discuss pertinent matters.

MIS The Company implemented the SAP B1 system on January 17, 2018, with ABACUS as the Implementation Partner. As stipulated in the agreement, annual updates are scheduled for every December. The most recent update was completed in December 2023.

Control Environment Foreign veterinary experts and comprehensive vaccination protocols are employed to uphold the health and vitality of the herd and prevent disease outbreaks. Environmental and nutritional management practices are implemented to ensure a stress-free environment and a nutritionally balanced diet for livestock. Herd size is carefully regulated in accordance with stocking density standards to ensure good care and to strive to keep mortality rates low. Optimizing breeding helps to ensure lactation yield remains within feasible levels for the farm.

Business Risk

Industry Dynamics Pakistan ranks fifth globally in milk production but has one of the lowest yields, with the average yield ranging from 12 to 14 liters per cow in contrast with international standards of 45 to 55 liters. Milk production is estimated to be 70 million MT during 9MFY24 (FY23: 68 million MT). The milk is divided into two main categories: loose milk (informal sector) and packaged milk (formal sector). The dairy sector operates in a highly informal manner with a minute share of packaged milk. Milk production is influenced by seasonal fluctuations and the breeding season, often resulting in lower yields from June to September. Price sensitivity, seasonal variations, and lack of infrastructure are key challenges specific to the industry.

Relative Position The Company owns a state-of-the-art dairy farm that adheres to international standards, maintaining a herd size of over ~ 4300 cows which reflects its good position in the market.

Revenues The Company's revenue has shown consistent growth over the years. In 9MFY24, SDPL reported a topline of PKR ~3,198mln (9MFY23: PKR ~2,431mln, FY23: PKR ~3,401mln) mainly attributable to the inflationary impact on milk pricing. The product line mainly includes raw milk, followed by dairy products and fruit beverages. Nestlé Pakistan remains the prominent customer for fresh raw milk. The Company's sales of dairy products include its own brands such as Rivayat, True Milk, and Karak (a tea whitener). In the fruit beverages segment, the company operates with the brand Mood.

Margins In 9MFY24, the gross profit margin improved to 7.6% (9MFY23: 3.6%, FY23: 3.1%), while the net profit margin declined to 1.1% (9MFY23: 10.6%, FY23: 8.7%). The volatility in margins is mainly attributable to the revaluation impact on dairy livestock and gains/losses on the sale of animals.

Sustainability The management of the Company is mindful of aligning its performance with financial projections. The adoption of contemporary genetic improvement practices in dairy breeds has enabled the Company to enhance the milk yield of its cattle base. Moreover, the Company's strategy to tap into export markets, particularly for fruit beverages, will augment the business sustainability.

Financial Risk

Working Capital The operational dynamics inherent to the dairy sector have culminated in a noteworthy financial metric for the Company, with its net cash cycle days portraying a negative trajectory. This characteristic is underscored by swift inventory turnover and minimal cash tied up in inventory. In 9MFY24, the net working capital days stood at -5 days (FY23: -24 days), primarily due to a decrease in trade payable days. The Company's working capital requirements primarily stem from the procurement of feeds for farm animals, which are aptly managed through short-term borrowing.

Coverages In 9MFY24, the Company's Free Cash Flow from Operations (FCFO) recorded at PKR 199mln. The Coverages of the Company is considered adequate and remained stagnant as of 9MFY24, with the interest coverage ratio noted at 0.8x (FY23: 0.8x).

Capitalization The Company maintained a moderately leveraged capital structure, with a leverage ratio of 37.9% as of 9MFY24 (FY23: 33.8%). The equity base of the Company was reported at PKR 3,787mln. The total borrowings increased to PKR ~2,315mln in 9MFY24, with short-term borrowings stood at PKR 1,060mln and long-term borrowings stood at PKR ~1,090mln. The sustainability of the equity base in relation to the Company's debt remains significant.

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Financial Summary
PKR mln

Sapphire Dairies (Pvt.) Limited	Mar-24	Jun-23	Jun-22	Jun-21
Dairy	9M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	5,320	5,102	4,913	4,003
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	1,402	1,375	928	601
a Inventories	*37*	*36*	*34*	*7*
b Trade Receivables	*119*	*76*	*45*	*48*
5 Total Assets	6,722	6,477	5,840	4,604
6 Current Liabilities	338	522	591	425
a Trade Payables	*128*	*261*	*387*	*260*
7 Borrowings	2,315	1,916	1,416	1,734
8 Related Party Exposure	-	-	-	7
9 Non-Current Liabilities	282	288	377	298
10 Net Assets	3,787	3,750	3,457	2,140
11 Shareholders' Equity	3,787	3,750	3,457	2,140
B INCOME STATEMENT				
1 Sales	3,198	3,401	2,573	1,876
a Cost of Good Sold	*(2,954)*	*(3,297)*	*(2,795)*	*(1,969)*
2 Gross Profit	244	104	(222)	(94)
a Operating Expenses	(143)	(65)	(281)	(189)
3 Operating Profit	100	40	(503)	(282)
a Non Operating Income or (Expense)	*219*	*473*	*2,081*	*465*
4 Profit or (Loss) before Interest and Tax	319	513	1,578	183
a Total Finance Cost	*(242)*	*(216)*	*(174)*	*(114)*
b Taxation	*(40)*	*(3)*	*(84)*	*(30)*
6 Net Income Or (Loss)	37	295	1,320	38
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*199*	*178*	*(362)*	*(129)*
b Net Cash from Operating Activities before Working Capital	*(30)*	*(22)*	*(520)*	*(244)*
c Changes in Working Capital	*(230)*	*(705)*	*4*	*117*
1 Net Cash provided by Operating Activities	(260)	(726)	(516)	(126)
2 Net Cash (Used in) or Available From Investing Activities	(115)	124	992	(971)
3 Net Cash (Used in) or Available From Financing Activities	376	501	(370)	1,100
4 Net Cash generated or (Used) during the period	0	(102)	105	2
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	25.4%	32.2%	37.2%	31.3%
b Gross Profit Margin	7.6%	3.1%	-8.6%	-5.0%
c Net Profit Margin	1.1%	8.7%	51.3%	2.0%
d Cash Conversion Efficiency (FCFO adjusted for Working Ca	-1.0%	-15.5%	-13.9%	-0.6%
*e Return on Equity [Net Profit Margin * Asset Turnover * (To*	1.3%	8.2%	47.2%	1.8%
2 Working Capital Management				
a Gross Working Capital (Average Days)	12	11	10	11
b Net Working Capital (Average Days)	-5	-24	-36	-37
c Current Ratio (Current Assets / Current Liabilities)	4.1	2.6	1.6	1.4
3 Coverages				
a EBITDA / Finance Cost	0.9	1.0	-2.0	-1.2
b FCFO / Finance Cost+CMLTB+Excess STB	0.5	0.5	-0.8	-0.2
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fin	-22.0	-30.8	-2.4	-6.4
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equity	37.9%	33.8%	29.1%	44.9%
b Interest or Markup Payable (Days)	83.9	103.9	95.2	93.1
c Entity Average Borrowing Rate	14.9%	12.9%	11.0%	6.5%

Credit Rating

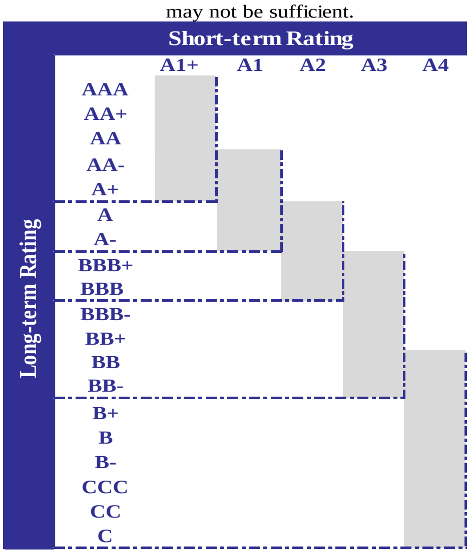
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 17-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument;| Chapter III | 17-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past; | Chapter III | 14-3(f)(vii)
Proprietary Information